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THE REFORM OF THE PUBLIC SECTOR AS THE KEY DETERMINANT OF THE TRANSITION ECONOMY OF THE REPUBLIC OF SERBIA

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The economy of the Republic of Serbia is at an important turning point now. The first phase of the implementation of the transition process is completed, the reform processes are gaining a new momentum and entering the European Union is becoming more certain. In order to successfully finalize the transition processes, the reform of the public sector's system of functioning is inevitable, among other reforms. The public sector in Serbia is low-productive and inefficient, irrationally set, with a multitude of problems that for many years have constantly been growing and becoming more complicated. The high rate of employment and average salaries in the public sector, on the one hand, and the poorly-formulated operational systems, on the other, are so designed that the public sector has a bad influence on economic development in general. The paper will analyze the situation in the public sector of the Republic of Serbia, with a special emphasis on creating a realistic basis for its reform, as a key determinant of the successful completion of the transition process, taking into account the specifics of the Republic of Serbia's economy.

Keywords: transition, reform of the public sector, business environment, pension system, social protection

JEL Classification: H10, H55, H60

INTRODUCTION

Without the activities that are responsibility of the public sector, no developed democratic society can be imagined, given that they include the establishment and maintenance of the legal order, the production

of public goods, public education, public health, the protection of the elderly, the protection of the poor, subsidizing certain industries, the construction of the infrastructure, encouraging scientific research and so on. The efficient functioning of the public sector is an important factor in maintaining macroeconomic stability, economic growth, the standard of living and social welfare. The absence of such features of the functioning of the public sector is a source of serious damage to the functioning of the entire economy.

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The size of the public sector of the Republic of Serbia is not an adequate match to the level of the gross domestic product, and each of its changes, either positive or negative, directly affects the state of the economy. The relation between the public sector and the economic system is a two-way and very causal one. The efficient public sector contributes to the development of the overall economy and *vice versa*.

The issue of the reform of the public sector has for years been emphasized as one of the imperatives of the successful completion of the transition and the creation of a suitable environment for successful economic development. Rationalization, wage cuts, the public sector reorganization and the restructuring of public enterprises are the essential postulates of the sustainability of the national economy. Nevertheless, the state cannot ignore the social aspect of life for the citizens of the Republic of Serbia, particularly through the health care reform, the pension system and the social security system.

The subject of this paper aims to show the importance of the reform of the public sector as part of the transition process that the Serbian economy is going through. Accordingly, the aim of this paper is to define the key routes or segments of the public sector reform in the Republic of Serbia. Starting from the defined object and the purpose of the research, we will proceed with the testing of the main hypotheses:

If you want a successful completion of the transition of the Serbian economy, it is necessary to implement a comprehensive reform of the public sector.

In accordance with the defined object and purpose of the research, in addition to the usual methodology used in economic research, the method of a comparative analysis will also be used in this paper.

In order to successfully end the transition processes in the Republic of Serbia, changing and optimizing the system of the functioning of the public sector are inevitable. This is one of the essential prerequisites for the economic recovery and a positive trend in the development of the economic system as a whole. To understand the importance of the public sector reform as a key determinant of transition, it is necessary to explain the basic components and characteristics of

the public sector. In this paper, the data on the number and the structure of public companies, along with the problems accompanying the public sector, primarily the permanent increase in the public debt caused by fiscal deficits and guarantees that the state provides public enterprises with for the purpose of their borrowing, will be analyzed. Along with the whole analysis, we will also present the specific measures that should lead to the successful reform of the public sector of the Republic of Serbia.

In addition to the introduction and the concluding remarks, this paper consists of three parts. The first part focuses on the basic features of the public sector of the Republic of Serbia; in the second part, the necessity of its reform will be pointed out; and in the third part, an accent will be put on the key segments of the public sector reform: the restructuring of public enterprises, the reform of the pension system, the reform of the health system, and the reform of social protection.

THE BASIC FEATURES OF THE PUBLIC SECTOR OF THE REPUBLIC OF SERBIA

The reform processes in the Republic of Serbia that have been set in motion are just another example of the fact that good initial results are not sustainable without fundamental changes in the institutional environment of business. In fact, a stable institutional infrastructure that creates a business environment conducive to long-term production growth, employment, investment and exports has not been fully created yet. Such an institutional infrastructure includes clearly designed, long-term and consistent economic system solutions in all areas of business (Veselinović, 2007, 54). The public sector is one of those areas.

The public sector is a part of the national economy, which includes the general government and nonfinancial enterprises controlled by the state (public companies), which are primarily engaged in commercial activities. This sector includes companies engaged in the activities of a common interest to all the citizens: the power utilities, the oil industry, all forms of transportation, postal communications and the

public utilities. The state or local governments are the founder of these companies.

The public sector of the Republic of Serbia has a long history that dates back to the period of the socialist system of the state and the society. During this period, the public sector represented the „long arm“ of the state, and the state used it to directly exert its influence on developments in the national economy.

The public sector of the Republic of Serbia consists of a number of public companies and therefore it can be viewed in the narrower and wider contexts. In the narrower context, the public sector of the Republic of Serbia is made from public companies at the national level of government, public enterprises at the provincial level of government and public enterprises at the local level, while in the broader context, in addition to these public enterprises, the public sector is made from all other companies and individuals that are both directly and indirectly do business with these public enterprises (Anđelić i Đaković, 2013, 60).

There are no official figures on the number of employees in the public sector of the Republic of Serbia, but all relevant estimates indicate that more than 700,000 workers are directly or indirectly employed in this sector, which is a significant share of the total number of employees – 1,698 million workers.

The importance of the public sector in the Republic of Serbia can be illustrated by the following data (Arsić i drugi, 2010, 143):

- through taxes and the public spending of more than 40% of the gross domestic product (GDP) of the Republic of Serbia is redistributed;
- public investments accounted for 15% of total investment.

The activities and functions of the state and the public sector are commonly called public needs. With his or her own effort, an individual is able to provide housing, food and clothing for him-/herself, or to satisfy part of their personal needs. However, internal and international security, health, education, culture, social security and many other achievements of modern society depend on the existence of an organized activity of the bodies of the state and public institutions.

The main characteristic of the public sector in the Republic of Serbia is its low efficiency and a high level of costs compared to the quality and scope of the services that the sector provides.

The logic of the functioning and organization of the public sector in the Republic of Serbia has not significantly changed over time, although the society has gone through major changes. The question that logically arises is why it did not happen. Why did the public sector of the Republic of Serbia not go through the changes that were necessary? Why did it not adapt to the change of the social order, social awareness and new market trends? The answer depends on the focus of the analysis. If we set the social consciousness of individuals in the Republic of Serbia as the principal object of an analysis, we could draw the conclusion that the main cause why the public sector has not changed lies in the ambition of the government to keep the situation unchanged, and the public sector can significantly help the government with respect to such an ambition. If we set the economic stability as the principal object of an analysis, then the reason for the public sector not changing might be the authorities' tendency to maintain their positions in the state via alleged economic stability. And, finally, resistance to change within the public sector is also one of the reasons why it is not changing.

In sociological terms, conditions and opportunities in the public sector should follow the situation and circumstances in a country. In the Republic of Serbia, this is not the case. If we analyze the period from the beginning of the 1990s, we can conclude that even in the most difficult periods the Republic of Serbia went through, the situation and circumstances in the public sector, for those employed in it and those collaborating with the sector, were not at all poor compared to those related to the corporate sector, which is privately-owned. A large number of public companies operated, or continued to operate with losses and, at the same time, the employees of these companies had a position that was significantly above the average of the economy as a whole. Practice shows that public enterprises are the largest businesses with operating losses, and that the same public companies regularly pay high salaries to their employees.

While trying to define the public sector of the Republic of Serbia, the relation between the number and the structure of public companies between certain levels of government is interesting to analyze. In the general public, as an example of public enterprises and the public sector in general, enterprises that belong to the national level are usually set. However, if one looks at the structure of the public sector of the Republic of Serbia, one can see that the distribution of the number of public companies in the Republic of Serbia is quite heterogeneous and that a large number of public companies are present at both the local and the national and provincial levels of the government.

The public sector of the Republic of Serbia is too large, and as such, has an adverse effect on the whole of the economy. High costs generated by the public sector represent a serious problem for the budgetary balance, and the level of the budget deficit is one of the most important problems in the economic policy of the Republic of Serbia. The expensive administration of the state directly raises the costs in the economy, thus destimulating current operations, as well as the investment behavior of domestic and foreign companies.

In most public companies, there is little opportunity to determine the optimal level of spending (investment). In such situations, the persons in charge try to spend as much as the approved budget allows, although the predicted amount in the budget may be higher than the objectively required amount. For this reason, many public companies are marked as inefficient operational organizations, and the need to change this point of view is justified (Krstić, Stevanović i Džunić, 2011, 434).

The key issues in the public sector of the Republic of Serbia are:

- the high cost of the public administration and the public services in the form of the wage bill of employees and their share in the gross domestic product;
- the common practice of forming a variety of government agencies and similar institutions, without a prior assessment of the existing infrastructure and an analysis of whether the organization performing those jobs or the one

having the capacity to perform them already exists in the country or not;

- the irrational spending of the budget funds by subsidizing inefficient public companies;
- the inefficient system of pension insurance, social security, health care, and education;
- the inefficient and bureaucratic administration that encourage the private sector to operate on the grey market.

The inefficiency of public enterprises is a particular problem. The analysis of the financial statements for the period from 2007 to 2011 shows that, except in the first year of the period, the public companies in the Republic of Serbia operated at a net loss in all other years. The biggest amount of the loss was recorded in 2009. In the total net financial result of the economy (the net loss), the share of all the public companies together was about $\frac{1}{4}$ (Ministarstvo finansija Republike Srbije, 2011, 19).

The pricing of services in the public sector contains a social component that does not provide economic sustainability, and debt collection mechanisms are inefficient. Management in the majority of these companies is inefficient and under the influence of political parties.

To better understand the necessity of the measures aimed at reforming the public sector of the Republic of Serbia, it is necessary to, first, consider the size of the public sector in the Republic of Serbia and compare it with the data from other countries. Also, it is important to see what the range of the average salary of employees in this sector is.

In the analysis of the public sector, the main question is what size and structure make this sector more efficient. The fact is that there is no single, optimal size of the public sector for all countries, as each country in a given period should evaluate the optimal size of the public sector.

Given the fact that there is no single methodology at the international level which would enable us to compare the size of the public sector by country, we will use the indicator of the participation of the public

sector employees in the total number of employees in a particular country. For the approximation of the size of the public sector across countries, we have used the data on the number of employees in the sectors of the public administration and defense, compulsory social security, health and social care and education (Ministarstvo finansija Republike Srbije, 2013a, 24).

According to this indicator (Figure 1), the public sector in the Republic of Serbia does not deviate from the public sectors in the selected countries of the European Union. This, of course, does not mean that its size is optimal, and there is still a possibility that there are too many employees in some segments of the public sector, while other segments have a lack of employees.

Figure 1 shows that, considering the number of the public sector employees in 2012, the Republic of Serbia is better than the neighboring countries (Bulgaria, Romania, Czech Republic), but it has fewer employees in the public sector than the certain EU countries Lithuania, Estonia, Latvia, Slovenia, Poland, Hungary and Slovakia.

Another indicator of the size of the public sector, or the share of public expenditure in the GDP (Figure 2), suggests that the size of the public sector of the

Republic of Serbia does not deviate much from the size of the public sectors in other countries. The public sector in the Republic of Serbia spends nearly as much as the public sectors in the Czech Republic and Poland, and a little more than the public sectors in Bulgaria, Romania, Croatia and Turkey.

The displayed data need to be updated with the data on the structure of these expenditures. In the Republic of Serbia, the expenditure on salaries in the public sector and pensions is more than 50% of the total public expenditure (in 2011, the share was 52.4%). The amount of public spending on pensions for about 1.6 million pensioners in 2011 was 23% as high as the amount for the expenses for about 470,000 employees in the public administration and public services. At the same time, the share of capital expenditure in public expenditure was around 8%. It is a means of maintaining the existing public investments and initiating new ones and the amount is less than the expenditure for the purchase of goods and services (for the current government spending), which is about 16% in the total public spending. The share of compensation for employees in the public sector in the gross domestic product of the Republic of Serbia was at the same level of the participation of these charges in Croatia and

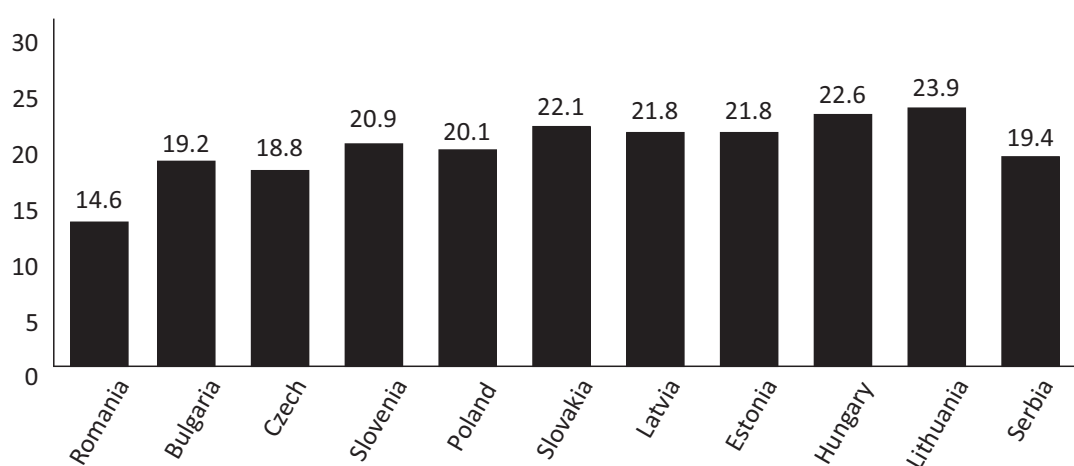


Figure 1 The share of the public sector employment in total employment in 2012 (in %)

Source: Author, based on: Eurostat, 2012; Republički zavod za statistiku, 2013

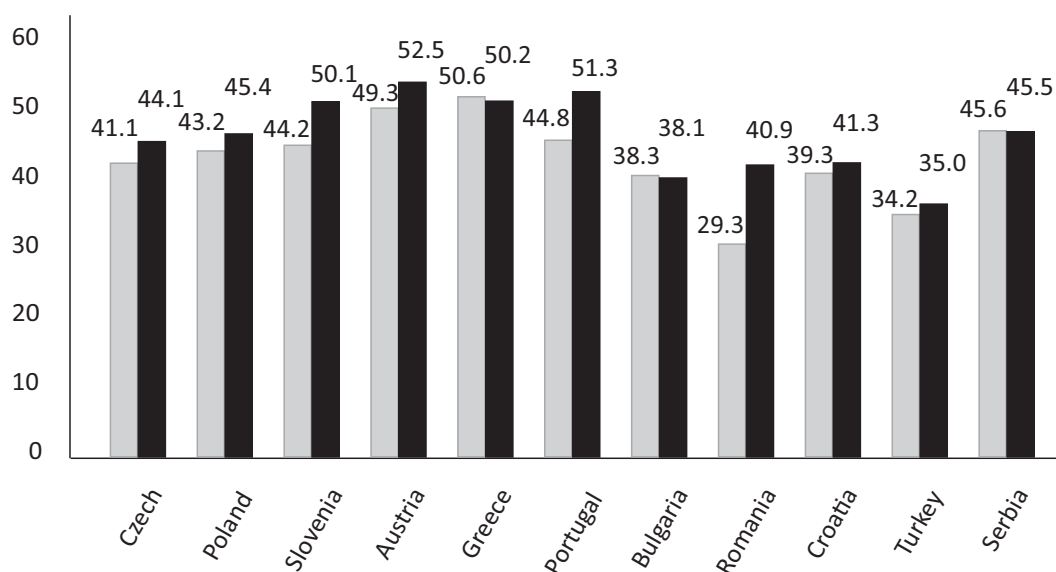


Figure 2 The share of public expenditure in the GDP (in %)

Source: Author, based on: IMF, 2014, *Government Finance Statistics*

Poland, but above the level of such participation in Bulgaria, Romania, Austria and the Czech Republic.

Taking into account the transition process in the Republic of Serbia and its impact on the labor market, the relationship between employment in the public sector and the real sector has often been questioned. The transition is known to have affected the decline in the gross domestic product and the growth rate as well as the labor market characterized by high unemployment, a low level of employment in the private sector and a lack of labor mobility (Đuričin, 2011, 234-260). Therefore, numerous works highlight the importance of strengthening the private sector as the driving force of the labor market, with a particular emphasis on the efficient use of the potential of small and medium-sized enterprises.

The average salary in the public sector is higher than the average salary in the Republic of Serbia (Table 1). The average net salary in the Republic of Serbia is only at 70% of the average net wage in the public sector enterprises, or 78.5% of the salary in the public administration. As an excuse for higher wages in the public sector *versus* the private sector, the higher level

of the qualification of employees in the public sector is usually listed. However, there are also significant differences in the level of earnings for the same level of qualifications within the public sector, which makes it necessary to establish a clear principle in the system of wage determination, or the equalization of wages for the same level of qualification.

Table 1 The average net salary in the Republic of Serbia in the private and public sectors (in dinars)

	2009.	2010.	2011.	2012.	2013.
Average net salaries (total)	31.733	34.142	37.976	41.377	44.182
Average net salaries in the public sector	38.885	39.810	43.506	46.551	48.969
Average net salaries in the private sector	24.581	28.474	32.446	36.203	39.395

Source: Ministarstvo finansija Republike Srbije, 2013b, 30-33

Based on the data from Table 1, Figure 3 shows a disproportion of the wages in the private and the public sectors of the Republic of Serbia.

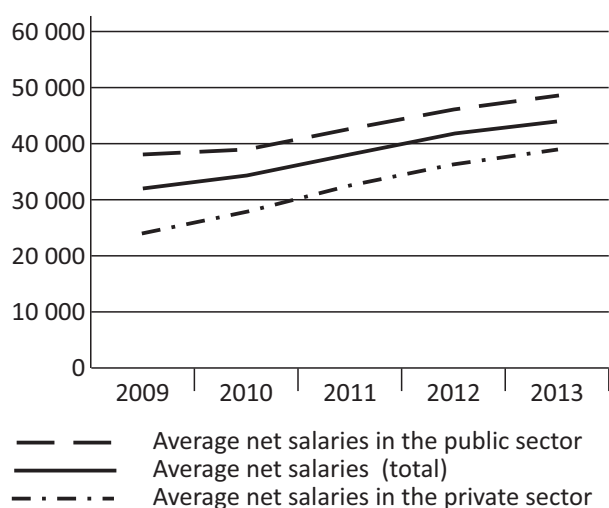


Figure 3 Average net salary in the Republic of Serbia (in dinars)

Source: Author

According to the data of the National Bureau of Statistics, in the period from 2009 to 2013, the wages in the public sector in the Republic of Serbia were 28% higher than the average one in the private sector, and in some companies they were many times as high: 190% at „Srbijavode“ and Airport „Nikola Tesla“, 180% at „Telekom“, 160% at „Srbijagas“. The average wage in the public sector in July 2013 was 48,969 dinars, while the average salary in the private sector during the same period was only 36,257 dinars. Wages in the public sector compared to the private sector are also high in the neighboring states, but not as high as in the Republic of Serbia: 20% in Romania, 19% in Bulgaria, 15% in Slovakia, and 8% in Hungary. The Republic of Serbia spends around 13% of the GDP on the wages in the public sector, which is twice as much as Slovakia or Slovenia spend.

THE NECESSITY OF THE REFORM OF THE PUBLIC SECTOR IN THE REPUBLIC OF SERBIA

The issue of the public sector reform is one of the fundamental issues of the reform process in the economies of countries in transition. In recent decades, there have been significant changes on the market, in terms of the mode of operation, information, connectivity and effectiveness, all of which have resulted in the need for the redefinition of the role and importance of the public sector in market trends. The public sector reform in transition countries is specific because, in many countries, it either has not started yet or is very slow.

The reform of the public sector of the Republic of Serbia should be seen as a continuous and systematic activity directed towards a clear choice of the public sector that is necessary in the Republic of Serbia. Therefore, before we define the specific directions and measures of the reform of the public sector in the Republic of Serbia, we should first perform a thorough analysis of the current situation in order to obtain a clear and convincing picture of the state of the entire socio-economic system of the Republic of Serbia. This analysis should include, among other things, the following aspects:

- the economic aspect (what the current economic situation of business entities is and how it could be improved);
- the institutional aspect (which laws need to adapt and change in order to successfully implement the reform);
- the social and psychological aspects (what the mood of the population is in terms of their willingness to reform the entire socio-economic system, and the public sector within it).

When we look at these aspects, we can speak about the possible directions of the reform of the public sector of the Republic of Serbia. It is clear that they should be directed towards:

- the corporatization of the public sector,
- more public-private partnerships and

- a combination of the previous two models.

The corporatization of the public sector of the Republic of Serbia requires a complete redefinition of the institutional public sector in terms of creating public companies, which would consequently lead to the redefinition of organizational and management approaches in these companies. The advantages of this approach are reflected in the fact that the operations of the public sector would to a greater extent adapt to the market needs, whereas one of the main drawbacks lies in a potential danger of changing the ownership structure and the impact of private equity on its functioning. This circumstance could create some challenges since the interest of private investors and the state is known to often be different from each other (investors are primarily guided by the motive of profit maximization, and the state also has to take care of the social and other needs, which is a natural thing to do). However, this model could contribute to increasing productivity and efficiency in the public sector because responsibility in business could clearly be determined. If, along with the implementation of this model, the total professionalization of the public sector would be insisted on, this model could provide satisfactory results.

A public-private partnership is the model which has been the subject of many debates and theories for a long time. Developed countries' experiences support the idea that this model has greatly been optimized for certain activities that are now covered by the public sector. There is, however, a logical question of the possibilities of the practical implementation of this model in the Republic of Serbia.

A public-private partnership is a long-term contractual partnership between the public and the private sectors, which may include: the design, financing, construction, management or provision of services by the private sector, which are traditionally provided by the public sector. In fact, it is the model that brings benefits to both sides and includes the successful combination of the objectives of the public and the private sectors. A public-private partnership is a common corporate operation of the public and the private sectors aimed at a more economical, more efficient and successful production of public goods or

services compared to the traditional way of providing services. In this case, the public sector is a partner that, in the contract, defines the type and scope of work or services he or she intends to transfer to the private sector. The private sector emerges as a partner that requires such cooperation if a profit can be made, and is required to properly execute the tasks defined in the contract (Dimitrijević i Cvetković, 2010, 121-130).

The result of combining the previous two models would be considerable flexibility and a possibility of adapting the offered solutions, with full consideration of the particularities of the public sector of the Republic of Serbia at the national, provincial and local levels. On the other hand, there is a real danger that this combined approach could prove to be inapplicable because the socio-economic system of the Republic of Serbia is still not ready for such an arrangement of the public sector. It seems that a combination of the previous two models would be the optimal solution for the Republic of Serbia, which, however, cannot be claimed with certainty as long as it has performed the necessary analysis and an assessment of the situation and the opportunities in the Serbian market, with a projection of expected trends.

The public sector reform has been an inexhaustible topic in recent years. The perennial politicization of the public sector, the irrational economic, personnel and general business policies, the lack of the understanding of the position of the public sector in modern society and the unwillingness on the state's part to rationally start its reform are just some of the reasons for the low productivity of and the undercapitalized public sector. The global financial crisis has further aggravated the situation in the region, and the reaction of the economic policy was an inadequate one. The reaction of the fiscal and monetary policy was uncoordinated, mainly extracted, and almost like there was no crisis at all. Under the pressure from the political elite, the fiscal policy met part of the populist campaign promises, and increased public spending despite the crisis (Petrović, 2009, 43).

All of the above-mentioned shows that it is necessary that the legacy of the previous period should be cleared up, and, following the example of the countries that have the well-appointed public sectors, that the

reforming of the public sector of the Republic of Serbia should be started. A stable public sector is well-known to be the basis of the development of the country and the foundation supporting its long-term economic progress, while an unstable public sector slows down the development of the country.

THE KEY SEGMENTS OF THE SERBIAN PUBLIC SECTOR REFORM

According to the above analysis, we can see that the reform of the public sector of the Republic of Serbia is a very complex process which should include: the restructuring of public enterprises, the pension reform, the health care reform and the reform of the social protection systems.

The scientific and professional community differently defines the term „public company”, which rightfully raises the question of what is public and why it is public. The Law on Public Enterprises defines the notion of a public company as a public company performing the activities of a general interest, established by the state or the local government or the autonomous province. However, the Law on Public Enterprises shows that the activities of a general interest may be performed by other companies and other entrepreneurs.

According to the legislation of the Republic of Serbia, public companies can operate with the state-owned and private resources and resources of other forms of ownership. These are companies doing business in the public interest. The subject of their activities is products called public goods and public services. A public good is any good produced in the field of a public economy. It is characterized by non-rivalry and non-excludability. Non-rivalry means that, at any stage of a commercial use, it is impossible to exclude any other individual consumer from consumption. Non-excludability means that a good intended for a certain individual or group can be used by other people, at little or no additional costs.

In the Republic of Serbia, there are 715 public and public utility companies that are listed at the National Bank of Serbia. In the Business Registers Agency, 703 companies are registered as active (five are in

the registration process, five in bankruptcy and two in liquidation proceedings). Companies such as „Srbijagas”, „Železnice Srbije”, „Putevi Srbije”, „Elektroprivreda Srbije”, „Pošta Srbije”, „Elektromreže Srbije”, Belgrade „Nikola Tesla” Airport, „Telekom Srbija”, „Srbijašume”, „Srbijavode”, „Vojvodina šume” and similar ones, employ a significant number of people, have a great asset and are vital to the entire economic system of the Republic of Serbia.

The realized losses reported in the annual accounts of most public companies indicate that they are in a worrying situation. Their inadequate management and their long-standing effort to balance between the social and the market ways of doing business have led such companies to a precarious financial situation.

The biggest problems faced by public companies in the Republic of Serbia are as follows:

- a great political influence in the election of the members of the management and the supervisory boards, which results in weak corporate governance and poor business results;
- losses have been accumulated for years, hampering the investment and development opportunities of this type of companies;
- the very low effectiveness and efficiency of the management, which is reflected in the quality and range of products and services of these companies;
- financial imbalances – public enterprises operate as illiquid and have high rates of indebtedness, which is mostly the consequence of a lack of the capacity of this sector of the company in the area of financial management;
- great opportunities for corruption and
- redundancy and the inadequate qualification and age structure of employees.

Many problems arise in public enterprises at the local level, and they are reflected in: technical and technological obsolescence, the oversize of many of these enterprises, propensity for irrational consumption while there is high indebtedness, a loss and a high budgetary dependence, as well as

an inability to finance participation in large-scale investments with their own resources.

Since the beginning of the transition in the Republic of Serbia, there has been no attempt to implement areal process of the restructuring of public enterprises. In the period after 2000, most changes were aimed at changing the organizational structure and staff reductions. Despite the measures taken, public companies in Serbia still do not produce results commensurate with their importance, expectations and great business potential.

It is important to note that, in the professional community, there are still conflicting opinions about privatization, which just highlights the importance of the process of the restructuring of public enterprises, prior to privatization. Thus, the conclusion is that, regardless of whether public enterprises will be privatized or not, the continuation of such restructuring is necessary in order to improve their efficiency.

Two main groups of factors affecting the process of the restructuring of public enterprises in the Republic of Serbia can be categorized into external and internal factors (Mihajlović, Mihić i Rađenović, 2013, 157-176).

External factors are closely related to an inappropriate institutional environment. The generator of this environment is certainly the government of a country. It is an institutional environment that has been lacking the most throughout the transition period, in order to generate changes in the business environment, because companies operating in the conditions of developed markets feel the inner need but are also forced to go through various restructuring activities. This is necessary to ensure the survival, growth and development.

Internal factors simply „push” companies to go through changes and restructuring. Internal factors are reflected in the owner’s pressure on the managers to bring the company to create a high level of well-being. One gets an impression that, in public enterprises in the Republic of Serbia, it is not clearly defined who is the one to set goals, lead the company towards the achievement of the goals set and exercise control.

Without clearly defined ownership relations, there is a lack of a very important internal momentum for the restructuring of public enterprises to make changes in order to create and strengthen their financial situation.

The current situation that public companies are in requires an urgent initiation of the restructuring process that cannot be universal and applied equally to all. This process needs to be continuously implemented in each company, taking into account their specifics. The restructuring process will vary from one company to another, and in most companies, it implies cutting the number of employees and improving governance.

Improving the management of public enterprises should contribute to increasing their efficiency by reducing unnecessary waste of resources, increasing the volume and improving the quality of services, upgrading technology etc. Increasing the efficiency of public enterprises is of great importance for the economy and the citizens, not only because of the great value of the services they deliver but also because of a large part of social wealth being under their control.

A significant segment of the reforms of the public sector of the Republic of Serbia refers to the reform of the pension system.

The public pension system of the Republic of Serbia is based on the principle of inter-generational solidarity – active workers pay pension contributions which are used to payout current retirees.

Pension insurance is divided into three pillars:

- the first pillar is mandatory state pension insurance. It works on the principle of current financing, where contributions paid into the Pension Fund on behalf of the employer and employees are immediately paid out in the form of pensions to current retirees;
- the second pillar is mandatory supplementary private pension insurance, in which a portion of mandatory contributions that would go into the state pension fund is directed to the compulsory private pension fund, so that the employee may be entitled to two pensions – the private and the state ones;

- the third pillar is voluntary pension insurance, which gives an opportunity to all, regardless of whether they are employed or not, to allocate additional pension contributions to private accounts and ensure additional benefits in the future.

The Republic Fund for Pension and Disability Insurance is established under the Law on Pension and Disability Insurance to ensure the exercise of rights from pension and disability insurance and to provide funds for the realization of these rights (Raičević, 2008, 304). The Fund is a legal entity with the status of an organization for mandatory social insurance, with the rights and obligations established by the law and the statute. The Fund provides the right to pension and disability insurance to all persons who are insured by law and who are included in this insurance, regardless of whether they are employees, self-employed or farmers.

Faced with new structural socio-economic and demographic changes, such as a tendency to increase life expectancy, unemployment and the negative effects of high pension insurance contributions on employees' paid-outwages, policy makers have a great limitation in increasing public spending on behalf of pension payments. The increase in pension expenditure has become the main burden of public finances in the Republic of Serbia in recent decades. Therefore, an increase in the pension expense requires the reforming of pension insurance in order to increase the contribution rates, the changes of the accounting period for determining the pension right and the mechanism of adjusting the amount as well as the reduced pension rights.

Public expenditure on pensions is based on demographic and macroeconomic values. The birth rate, life expectancy and migration flows, macroeconomic trends, the pace of the gross domestic product, wages, reduction of the employment rates and social factors (early retirement, claims for disability pensions) are the most important elements determining the movement of the state pension insurance funds. The level of public expenditure on pensions is certainly affected by change of legislation (the mechanism of the adjustment of pensions to the current economic conditions or the indexation

mechanism, the regulated conditions for retirement etc.) (Hrustić i Dimitrijević, 2009, 89-101).

The Table 2 data show that the number of insured persons comparing to the number of beneficiaries decreased from one year to another. This merely shows how real a possibility of the sustainability of the pension system were if the trend of increasing the number of retirees relative to the number of employees continued.

Table 2 Developments of the number of retirees and the number of insured persons in the category of employees in the Republic of Serbia

Year	Number of	Number of	Ratio
	retirees	insured people	
	1	2	1:2
1999	1.263.315	1.992.181	1:1,5
2000	1.264.175	1.927.588	1:1,5
2001	1.297.004	1.919.255	1:1,5
2002	1.255.814	1.876.390	1:1,5
2003	1.248.662	1.841.219	1:1,5
2004	1.241.082	1.841.656	1:1,5
2005	1.239.573	1.839.461	1:1,5
2006	1.267.574	1.792.497	1:1,4
2007	1.290.611	1.760.437	1:1,4
2008	1.306.394	1.772.418	1:1,4
2009	1.324.338	1.678.760	1:1,3
2010	1.345.733	1.605.052	1:1,2
2011	1.357.846	1.542.282	1:1,1
2012	1.420.892	1.518.792	1:1,1

Source: Republic Agency for Pension and Disability Insurance, 2012

For the optimal functioning and liquidity of the pension system, it is better that there are more employees perone retiree. It is very important to note that this relationship is significantly influenced

by the fact that, in the Republic of Serbia, there is a strong tendency of the aging of the population, thus increasing the number of retirees from one year to another. Also, as unemployment grows from one year to another, and as many young people cannot find work, this ratio will continue to move unfavorably because of the downsized number of employees comparing to the number of retirees. That is why creating new jobs is believed to be an indirect factor that can affect the improvement of this relationship in the future, reducing unemployment in that way. However, there is another factor that may affect the favorable trend of this relationship, and that factor is lifting the age limits for retirement.

Although the pension system reforms were repeatedly being implemented during the period from 2002 to 2010, the Republic of Serbia remains in the group of countries with the questionable sustainability of the public pension system. Pension expenditures are 13% of the GDP, which is 4.5% more than the average in the European transition countries, which is a burden on the economy and taxpayers that they cannot withstand in the long run.

One of the causes of the unsustainable pension system is the fact that the current reform measures have not sanctioned retiring before the regular retirement age, so that about 70% of men retire before the age of 65 and

about 50% of women retire before the age of 60 (Figure 4).

In the European Union, there is a continuing trend of lifting the age limits for retirement; so in the UK, men retire at 65 and women at 60; in Portugal, women retire at 62 and men at 65. In Greece, the standard age limit for pension has increased to 65 years for both men and women.

Bearing in mind the above analysis, it is very important to impose the following measures of the reform of the pension system of the Republic of Serbia:

- The introduction of actuarial factors or penalties for early retirement and rewards for late retirement. This measure would allow the pension system to be financially neutral towards the insured (the same generation) who retire at different ages. In practice, this would mean that the insured who retired earlier/later would receive a proportionately reduced/increased pension, in order to achieve a financial equivalence between insured persons who retire at different ages.
- The gradual equalization of the age limit for retirement for men and women to 65 years of age. This measure has been a subject of debate for years, not only in the domestic literature but also in the foreign one as well. It effectively allows you to

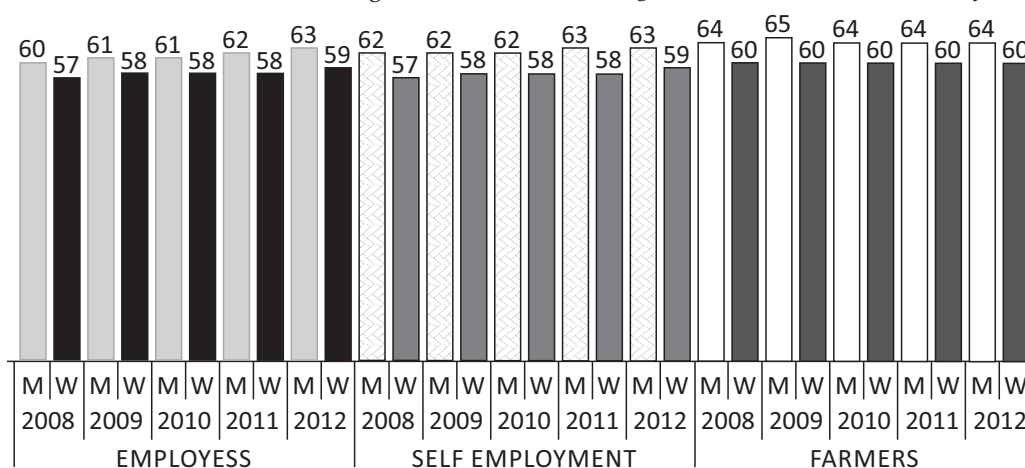


Figure 4 The average age of retirees in the Republic of Serbia in the period from 2008 to 2012

Source: Author, based on: Republički zavod za penzijsko i invalidsko osiguranje, 2012

extend the length of service of employees, and thus extend the period of the payment of contributions into the Pension Fund. The prolonging of life expectancy should particularly be taken into account at this point because it further affects the raising of the age limit for retirement. In fact, as life expectancy increases, the age limit for retirement should also increase. Because if that didnot happen, the ratio between the number of employees and retirees would be more and more unfavorable, which would have a negative impact on the liquidity of the Pension Fund. Figure 5 shows the age limit for retirement after the reforms implemented in 2012.

- Increasing the age of retirement for both sexes, according to the increasing life expectancy of the population. Policy makers in the Republic of Serbia have increasingly been emphasizing a possibility of legally increasing the age limit for retirement to 65 years for both men and women. However, a certain level of carefulness has to be employed with the implementation of this measure, because

if gaps in the financial balance still existed after implementing all these measures, the last step would be to consider an increase in the contribution rate. This is the most rigorous measure that could adversely affect the standard of the current employees, if there were not a proportionate increase in their salaries.

- The introduction of a reduction of the pension contribution for retired persons who work. Taking into account the results of the previous reforms of the pension system and the need to adapt to demographic changes, the long-standing problem of the insolvency of the pension fund should be dealt with at a higher pace of the economic activity that would primarily be directed towards the growth of the gross domestic product and employment. In addition, it is necessary that the pension system itself should be reformed, as defined pension benefits relate to the lump sum payments of a part of the contribution, not the present value of an annuity (Clark, Sandler Morrill & Vanderweide, 2014, 73).

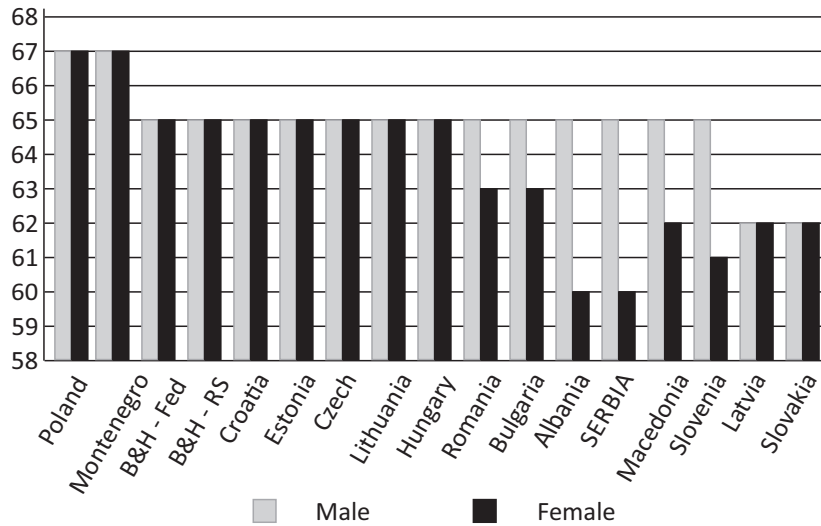


Figure 5 The average age of retirees in the Republic of Serbia and other countries following the reform in 2012

Source: Altiparmakov, 2013, 45

The reform of pension insurance requires a change in the calculation period for determining the amount of the pension; then, changing the indexation, tightening the eligibility conditions – the most important being an increase in the standard age limit for retirement. On the other hand, we must not forget that the quality of life and the level of the purchasing power of pensioners are also a social category, and the scope for further reducing the amount of pension is extremely narrow according to the current economic indicators in general. Especially in the context of the global financial crisis, the amount of pension is a segment that should certainly be protected by measures of mitigating the effects of the crisis.

To stimulate the economic recovery and to create conditions for economic growth should certainly be a priority in solving the problem of the illiquidity of the pension insurance system in the Republic of Serbia. However, economic policies should stimulate increased production and employment, thereby increasing the number of taxpayers and the volume of

collected revenues from pension contributions at the same time.

A significant segment of the public sector reform in the Republic of Serbia also refers to the reform of the health care system.

Public expenditures on health care in the world have been well-known to be one of the fastest-growing elements of public expenditure over the past few decades. Empirical studies show that technical progress in medicine, increasing access to health care for a large part of the population, and the aging of the population, all have the greatest impact on the cost of health care in relation to the gross domestic product.

According to the World Health Organization, public expenditure on health care in the Republic of Serbia accounts for about 70% of the total expenditure on health (Arsić i drugi, 2010, 166). If we look at Figure 6 including data up to 2011, we will see that the share of the total health care expenditures in the gross

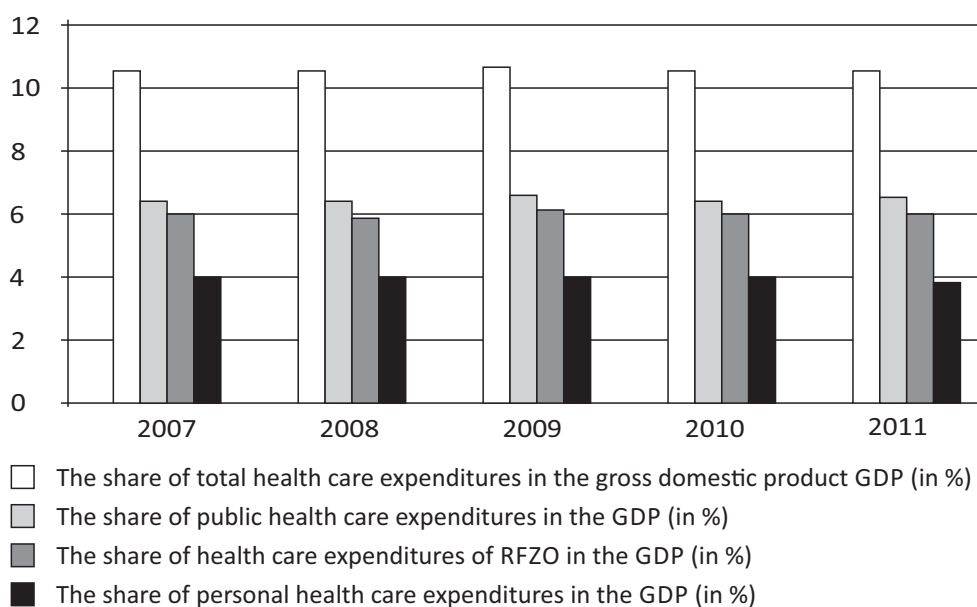


Figure 6 Funding by the source of the international classification of health care expressed as a percentage of the gross domestic product (GDP)

Source: Author, based on: Institut za javno zdravlje Srbije, 2011

domestic product of the Republic of Serbia increased by one percentage point in 2008 in comparison with the previous year, and stabilized at 10.4% in the following years, with a slight increase to 10.5% in 2009. The share of private expenditures on health care stabilized at 4% of the gross domestic product after an increase of half a percentage in 2008. The share of the public expenditure on health care of the Health Insurance in the gross domestic product was approximately 6% during the monitored period; in 2007, however, it increased by half percent, slightly fluctuating over the next two years. The share of public expenditure on health care in the GDP was 6.4% on average during the entire period.

Looking at spending on health care as a percentage of the gross domestic product, the Republic of Serbia, with its 10.4%, is close to the level of Belgium, Austria, Greece and Bosnia and Herzegovina, and is at a much higher level than numerous countries: Albania, Bulgaria, Croatia, the Czech Republic, Estonia,

Finland, Hungary, Latvia, Lithuania, Luxembourg, Montenegro, Poland, Romania, Russia, Slovakia, Macedonia and Turkey.

However, Figure 7 shows that, compared with the European Union and other European countries, the Republic of Serbia assigns a small absolute amount of funds for health care as a result of the relatively low level of the gross domestic product.

Given the fact that, relative to the gross domestic product, public expenditures on health care in the Republic of Serbia are higher than in comparable countries in transition, and that the results of health care are average, it can be said that there are significant inefficiencies in the health system. It certainly raises the need for a fundamental reform of the health system, which would result in improving the efficiency of health care.

As recommended by the World Bank, the most important savings in the public health system of the

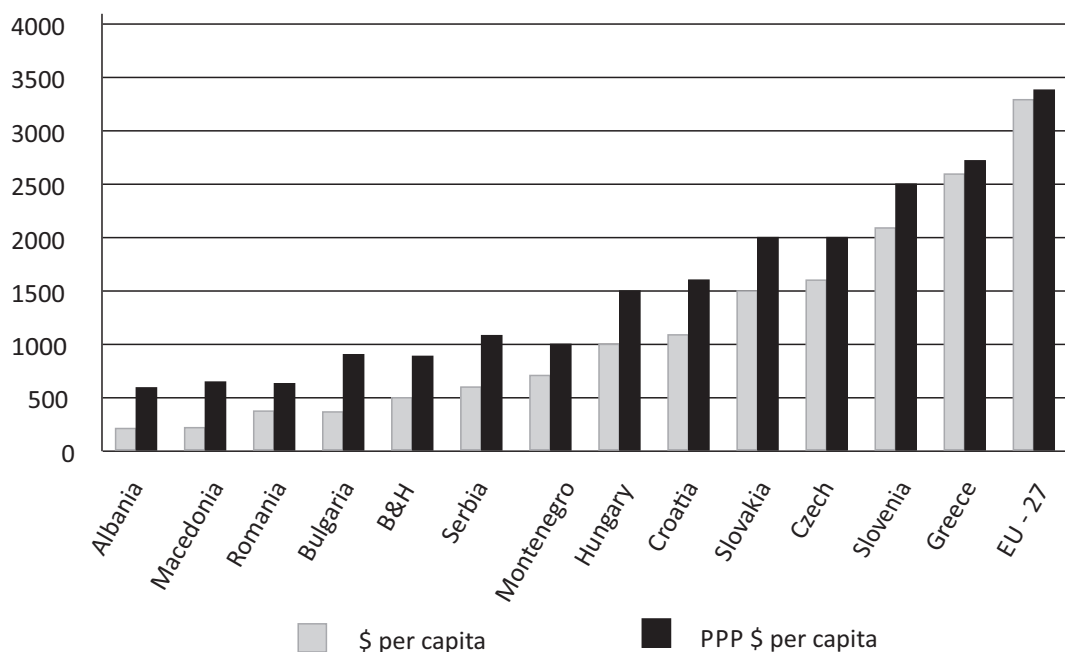


Figure 7 The total expenditure on health care (in U. S. dollars *per capita* and in U.S. dollars at purchasing power *per capita*) in the Republic of Serbia, EU-27 and the selected European countries

Source: Author, based on: Institut za javno zdravlje Srbije, 2012

Republic of Serbia are primarily related to the reduction in the number of non-medical staff in the areas of public health and the improvement of the decision procedures for the purchase of new technology and the approval of new drugs in the so-called positive list. A possible route could also be the computerization of the entire system of the administration of the services provided by health care facilities and the introduction of electronic charts. Namely, because the medical history of patients is still being recorded in a traditional manner, the overall system is functioning inefficiently, and is overloaded with a huge number of charts, and the patient data is often lost. An electronic database would help solve these problems and would provide easier and faster access to information about patients.

The realization of these reforms requires high vigilance in order not to repeat the mistakes that were made in the past. The reduction in the number of health care employees based on the voluntary departure of employees, with a relatively high severance, has resulted in the health care system being left without some of the most needed medical staff who switched to the private sector. At the same time, the number of non-medical staff, who were in a surplus, remained unchanged, which jeopardized the functionality of the health system.

The rationalization of the number of employees in the health system of the Republic of Serbia has to take into account the existence of significant disparities in the productivity of health care institutions. In fact, more than half of health centers have the capacity utilization of less than two-thirds, on the one hand, whereas, on the other, there are health centers that are overloaded. Such capacity utilization in health care institutions is partly the consequence of the fact that the demographics of the Republic of Serbia, from the territorial aspect, have significantly changed in the last twenty years.

According to the recommendation of the World Bank, a change of funding the public care system in the Republic of Serbia could contribute to the increasing efficiency of health care institutions. The current health care system is financed on a cost basis, health institutions receive funds from the Health Insurance

Fund based on the number and structure of employees, the cost of drugs and the number of beds. The key reform steps in this sector will involve a completely different model of funding, so health care will be financed by the users of health services. By using this model, health centers which have a larger number of patients would receive more funds. The savings in the health system that would be achieved by applying these measures would be used to purchase modern medical equipment, improve the qualification of medical personnel and reconstruct health facilities. Furthermore, significant resources could be diverted to the social welfare system.

In the Republic of Serbia, there are over twenty social assistance programs. The goals of these programs can be classified into three groups, namely:

- poverty reduction,
- population growth, and
- assistance to vulnerable groups (veterans and the disabled).

According to the official figures, expenditure on social protection in the Republic of Serbia is significantly lower than it is the case in most other countries in transition. The total expenditure on social protection is less than 2% of the gross domestic product, while these expenses in Central Europe range between 3 and 4%. However, if the various forms of the state aid are included, the actual expenditure on social protection in Republic of Serbia is likely to be somewhat higher because the Republic of Serbia is, in different ways, still shifting certain social functions to companies, so the poorer sections of the population receive discounts for paying utilities etc. (Arsić i drugi, 2010, 172).

Another drawback in the system of social protection is that a relatively small part of the social assistance programs are directly aimed at solving the problem of poverty. The relatively modest funds in the Republic of Serbia for the poor are insufficient; therefore, within the social protection programs, it is necessary that the funds that are directly intended for solving this problem should be increased. For these funds to reach those in need, it is necessary that administrative barriers, such as requests for the registration of

residence, personal documents, etc. should be eliminated. Among poor persons who are entitled to social assistance, there are a significant percentage of those who are illiterate and unfamiliar with the social welfare programs. It is therefore necessary for welfare services to actively assist such persons in achieving their right to social protection.

A social welfare reform in the Republic of Serbia should include the reformulation of the social policy so that it is fair and rational. An equitable social policy contains programs addressing the poorest. On the other hand, they should be fully involved in these programs. For example, the „Thirteenth Pension” social program only covers poor pensioners. However, they make up only 25% of the total number of the poor in the Republic of Serbia. A rational social policy makes sure that allocations do not threaten the stability of the budget. In the Republic of Serbia, for example, about one-third of the budget funds are allocated for pensions and social assistance, which is not sustainable in the medium term. Therefore, it is necessary that the existing resources be used more rationally (Fiskalni savet Republike Srbije, 2012, 12).

In the forthcoming years, it is necessary that social maps be created in order to finally determine who the poorest citizens are, and thus to enable the social programs to focus on them. The fiscal consolidation realized by increasing taxes, on the one hand, and a real decrease in wages and pensions, on the other, will result in a temporary further deterioration of the standard. Social pressure will be high, and the heavy burden of consolidation would be borne by the public sector employees, which is justified from an economic standpoint, because the public sector wages are higher than those in the private sector, and the risk of losing a job is smaller. Creating social maps would help social assistance to reach users who really need it, on the one hand, while, on the other, there would be a rationalization of the number of users.

It would be preferable to engage the local communities in the social welfare of the poor, which, after the amendment to the Law on the Financing of Local Self-Governments, have a lot more money, so some of this money could be used for social welfare programs. Local communities could be included in the social protection of those citizens who are in a difficult

financial position and do not receive assistance from the state budget. In this case, however, it is necessary to make a selection and do the targeting, so that the limited funding could reach those who are most in need of it. Therefore, a priority should be given to the measures aimed at helping families in extreme poverty, rather than measures not caused by the economic situation of users.

CONCLUSION

More than a decade after the start of the transition process in the Republic of Serbia, after the initial success, any significant progress has been lacking. According to the transition indicators of the European Bank for Reconstruction and Development and the indicators of international competitiveness by the World Economic Forum, the Republic of Serbia is falling behind successful transition countries and its economic growth is based more on domestic consumption and imports thanks to revenues from privatization and foreign borrowing than on the reforms and competitiveness (Maksimović, 2012). There are estimations that the Republic of Serbia has reached the level that successful countries reached in the 1990s, speaking from the perspective of the business environment, the implemented reforms and the European integration processes.

The Republic of Serbia and other Western Balkan countries are lagging behind in transition and therefore should accelerate the reform process and their integration into the European Union. Without accelerated reforms, it is impossible to increase the credibility of the country and reduce the investment risk. In this context, the public sector reform, the privatization of public enterprises, the development of public-private partnerships and reducing the grey economy and corruption are of particular importance.

In the process of joining the European Union, very complex requirements have been set for the Republic of Serbia, the fulfillment of which requirements being one of the main conditions for further progress in the integration process. Of course, a special emphasis is put on the public sector reform.

Changes in the public sector have their own institutional, economic, and social aspects. How specific changes in the public sector can be seen on the examples of the neighboring countries in which people react violently to the raise of the age limit for retirement, the reduction of employment in the public sector, and the privatization of public enterprises. The public sector reforms, including the rationalization of the sector, pension reform, social security and health care, affect all of us and the quality of our lives. Therefore, it is important that these changes be made slowly so as not to lead to a social unrest.

Often, the reform of the public sector is characterized by a painful process of transition, which must be taken into account by economic policy makers. This reform has a significant qualitative aspect. The quality of the public sector in the Republic of Serbia, especially in recent years, has been gaining more and more importance along with the need to modernize public services and the agreed objectives of the public administration reform. The introduction of the economic principles in the evaluation of public services and an increasing focus on the user demands are moving the public sector closer to the business sector. In addition to focusing on the user requests, the necessity of a continuous improvement within the public sector is also significant, which is another thing policy makers have to take into account.

This study has clearly highlighted the direction which the public sector should develop in, which, for the most part, has confirmed the hypothesis that in order for the transition of the Republic of Serbia's economy to successfully complete, it is necessary that a comprehensive reform of the public sector should be carried out. Of course, a number of open issues primarily related to the models and forms of financing the public sector remain of concern to the economic science and profession.

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